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CHAPTER 14

PROJECT AUDITS

I. OVERVIEW

This chapter provides guidance on federal and state audit requirements that are relevant to projects using CDBG Program funds received from the Montana Department of Commerce.

II. APPLICABLE STATE AND FEDERAL LAWS

A. STATE

1. Sections 2-7-501 through 2-7-522 of Montana Code Annotated (MCA) set forth the requirements for the audit of political subdivisions and is called the Montana Single Audit Act.
2. Title 2, Chapter 4, Subchapter 4 of the Administrative Rules of Montana (ARM) sets forth the regulations of the Montana Single Audit Act for political subdivisions.
3. Montana Department of Administration Local Government Services Compliance Supplement for Audits of Montana Local Government Entities sets forth some of the legal compliance matters which are important to financial operations of political subdivisions.

B. FEDERAL

1. The Single Audit Act of 1984 (31 U.S.C. 7501-7507) as amended by the Single Audit Act of 1996 (P.L. 104-156) is the principal federal audit statute. It imposes a set of audit requirements (outlined in this chapter) on recipients of federal grant funds, including CDBG funds.
2. OMB Circular A-133 (Audits of States, Local Governments, and Non-Profit Organizations), as revised June 24, 1997, sets forth the regulations issued by the federal Office of Management and Budget (OMB) to implement the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996.
3. OMB Circular A-133 Compliance Supplement, April, 1999 sets forth the principal compliance requirements for the largest federal aid programs, including CDBG.
4. Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments, 24 CFR Part 85. This part of the CFR (Code of Federal Regulations) establishes uniform administrative rules for federal grants and cooperative agreements and sub-awards to state, local and Indian tribal governments.

5. Government Auditing Standards, 1994 Revision (referred to as the "Yellow Book") contains generally accepted government auditing standards applicable to the grantee. Issued by the U.S. Comptroller General, these standards incorporate generally accepted auditing standards as adopted by the American Institute of Certified Public Accountants (AICPA).

III. AUDIT REQUIREMENTS

CDBG grantees must meet the audit requirements contained in OMB Circular A-133 under the terms of the federal Single Audit Act of 1984, as amended by the Single Audit Act of 1996. All local governments receiving federal grant assistance must do the following:

1. Regardless of the option selected, at a minimum audits must be conducted in compliance with generally accepted auditing standards established by the American Institute of Certified Public Accountants and the U.S. Comptroller General.
2. OMB Circular A-133 requires that auditees shall make positive efforts to utilize small audit firms, minority-owned firms owned, and/or women business enterprises, whenever possible, for audit services.
3. Your project's MDOC CDBG Program Specialist should be notified as to when an audit is to be conducted, by whom, and how the auditor was selected.

If your community's CDBG project is one that must be included in the **next organization-wide audit**, you may request **conditional** closeout approval from MDOC. Please follow the instructions in **Chapter 13, Project Closeout** (Page 13-4, Section 3.A., Procedure for Projects Required to Have Organization-Wide Audits). After the organization-wide audit including your project is completed, you **must request *final* closeout approval and submit a revised set of closeout documents reflecting the audit cost and results**. MDOC retains the right to recover funds based on the final audit.

If your community has a CDBG project that has the option of conducting **a separate project audit** (since the project is found to be exempt from the federal Single Audit Act's requirement of an organization-wide audit), you can contract for an audit through the MDOC Local Government Services Bureau. Please follow the instructions in **Chapter 13, Project Closeout** (Page 13-5, Section 3.B., Procedure for Projects Required to Separate Audits).

A. STATE AUDIT REQUIREMENTS

1. Audit Requirements Found in Montana Law -- Section 2-7-503(3), MCA.

Section 2-7-503(3) of the Montana Single Audit Act requires that the governing body or managing or executive officer of each local government entity receiving revenues or financial assistance **in excess of \$200,000** during the reporting period (1 year) must

provide for an **organization-wide audit** to be conducted **at least every 2 years**. This organization-wide audit must cover the entity's two preceding fiscal years. The audit must commence within 9 months from the close of the last fiscal year of the audit period. The audit must be completed and submitted to MDOC for review within 1 year from the close of the last fiscal year covered by the audit.

2. The purpose of the Montana Single Audit Act -- Title 2, Chapter 4, Sub-Chapter 4, ARM.

The purpose of the Montana Single Audit Act is to:

- a. Improve the financial management of local government entities with respect to federal, state, and local financial assistance.
- b. Establish uniform requirements for financial reports and audits of local government entities.
- c. Ensure constituent interests by determining that compliance with all appropriate statutes and regulations is accomplished.
- d. Ensure that the financial condition and operations of the local government entities are reasonably conducted and reported.
- e. Ensure that the stewardship of local government entities is conducted in a manner to preserve and protect the public trust;
- f. Ensure that local government entities accomplish, with economy and efficiency, the duties and responsibilities of the entities in accordance with the legal requirements imposed and the desires of the public; and
- g. Promote the efficient and effective use of audit resources.

3. Audit and Audit Report Standards

- a. All audits performed under section 2-7-503, MCA, must be conducted in accordance with Government Auditing Standards, issued by the U.S. Comptroller General that are applicable to financial audits. See ARM 2.4.411(3). Those standards incorporate generally accepted auditing standards as adopted by the American Institute of Certified Public Accountants.
- b. Audits must conform to the requirements of the Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996, (P.L. 98-502) and the OMB Circular A-133. See ARM 8.94.4111(4).
- c. All audit reports shall comply with the reporting standards for financial audits

prescribed in Government Auditing Standards as established by the U.S. Comptroller General, which incorporate the standards of reporting for financial audits prescribed by the American Institute of Certified Public Accountants. See ARM 8.94.4111(3).

- d. For audits conducted under the provisions of the OMB Circular A-133, the audit reports shall comply with the reporting requirements of that circular.

B. FEDERAL AUDIT REQUIREMENTS

Local governments that **expend \$500,000 or more in a fiscal year in federal awards** are subject to the federal Single Audit Act and OMB Circular A-133 and therefore must have a single or program specific audit.

General Scope of An OMB Circular A-133 Audit

OMB Circular A-133 audits must be conducted by an independent auditor in accordance with Government Auditing Standards. They must cover the entire operations of the local government or (if state law is not applied) -- at the option of the local government, the audit may include a series of audits that cover departments, agencies, and other organizational units that expended or otherwise administered federal awards during the fiscal year, provided that each audit encompasses the financial statements and the schedule of expenditures of federal awards for each such department, agency, and organizational unit.

The audit must cover the following areas:

- a. Financial Statements. The auditor must determine whether the financial statements of the local governments are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP).

The auditor must also determine whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the local government's financial statements taken as a whole.

- b. Internal Control Systems. The auditor must perform procedures to gain an understanding of internal control over compliance for each major program, assess the control risk, perform tests of those controls unless the controls are deemed to be ineffective. The auditor must perform procedures to obtain an understanding of internal control over federal programs that is sufficient to plan the audit to support a low assessed level of control risk for each major program.
- c. Compliance. The auditor must determine whether the local government complied with laws, regulations, and the provisions of contracts or grant agreements pertaining to federal awards that may have a direct and material effect on each of its major programs.

OMB Circular A-133 instructs auditors to make a special effort to detect possible fraud, waste, and mismanagement. In particular, audits should include a review of the local government's:

1. internal accounting and administrative control system;
2. drawdown practices;
3. use of project income;
4. direct costs charged to the CDBG program;
5. indirect cost allocation plans and indirect costs charged to the CDBG program, if applicable;
6. procurement practices;
7. property management practices; and
8. procedures and documentation supporting compliance with applicable laws, regulations, contracts and grant agreements.

The auditor may submit a preliminary report to the governing body for its review and comment. Local officials may work closely with the auditor to resolve any potential findings before the issuance of the final audit report.

If the auditor becomes aware of illegal acts or other irregularities, Section 2-7-515, MCA, and the Single Audit Act require that prompt notice be given to the chief elected official above the level of involvement. **The grant recipient, in turn, must promptly notify Montana Department of Administration of the illegal acts and irregularities and of proceedings instituted or to be instituted relating to the violations of law and nonperformance of duty.**

"Illegal acts and irregularities" include such matters as conflicts of interest, falsification of records or reports, and misappropriations of funds or other assets. The grantee should also inform the county, city or town attorney, as appropriate. If the county, city or town attorney fails or refuses to prosecute the case, the Montana Department of Administration may employ an attorney to prosecute the case at the expense of the respective governmental entity.

Four copies of the audit must be forwarded to the Local Government Services (LGS) Bureau, Audit Review Section, Accounting and Management Support Division, Montana Department of Administration. A copy of the audit report should be placed in the local project closeout file. Section 2-7-515, MCA, covers actions to be taken by governing bodies upon receipt of the audit report.

If there are audit findings, the grantee must, within 30 days of receipt of the audit report, prepare a corrective action plan outlining how the findings will be resolved and submit it to LGS.

Note that OMB Circular A-133 requires that at the completion of the audit, the auditee shall prepare a corrective action plan to address each audit finding included in the current year auditor's reports. The corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the auditee does not agree with the audit findings or believes corrective action is not required then the corrective action plan shall include an explanation and give specific reasons why no corrective action is necessary. LGS will notify the auditor whether the responses are sufficient. All audit findings must be resolved within six months of the issuance of the final audit report.

OMB Circular A-133 requires that the recipient submit copies of the audit reports and description of data collection form to the federal department or agency that provided federal assistance funds to the recipient (called the "cognizant agency"). The cognizant agency for Montana CDBG grant recipients is the Montana Department of Commerce, Audit Review Section, Local Government Services. Audit reports for other federal agencies that have provided federal financial assistance during the term of the CDBG project must be sent to the appropriate federal agencies. The reports shall be sent within 30 days after the completion of the audit, but no later than nine months after the end of the audit period. For fiscal years beginning on or before June 30, 1998, the audit shall be completed and the data collection form and reporting package shall be submitted within 30 days after receipt of the auditor's reports, or 13 months after the end of the audit period.

The auditee shall submit a data collection form that states whether the audit was completed in accordance with OMB Circular A-133, and provides information about the auditee, its Federal programs, and the results of the audit.

Grantees with more than \$500,000 of combined federal financial expenditures in any one year during the term of their project must, in addition, send one copy of the audit report, within 30 days after issuance, to the central clearinghouse designated by the federal Office of Management and Budget. The address for the clearinghouse for Montana CDBG grant recipients is indicated below:

**Federal Audit Clearinghouse
Bureau of the Census
1201 E. 10th Street
Jeffersonville, Indiana 47132- 4278**

C. SELECTION OF INDEPENDENT AUDITORS

1. Roster of Independent Auditors Authorized to Conduct Audits of Local Government Entities

- a. An independent auditor, as defined by section 2-7-501(6), MCA, must conduct local government entity audits under the provisions of Title 2, chapter 7, part 5, MCA. For purposes of this requirement, an "independent auditor" is a federal, state, or local government auditor who meets the standards specified in Government Auditing Standards as established by the U.S. Comptroller General; or a licensed accountant who meets the standards specified in Government Auditing Standards as established by the U.S. Comptroller General. See ARM 2.2.411 (3).
- b. In order to conduct audits of local government entities, an independent auditor must be on the roster of independent auditors authorized to conduct such audits that is maintained by the Department of Administration.
- c. In order to be placed on the roster, independent auditors must complete an application form prescribed by the Department of Administration and meet the criteria set out in this section.
- d. Independent auditors with separate offices registered as required by section 37-50-335, MCA, must submit separate application forms for each office that is to be placed on the roster.

To be eligible for inclusion on the roster, an independent auditor must:

1. if an individual, hold a current Montana certificate as a certified public accountant and hold a current annual permit to engage in the practice of public accounting under section 37-50-314, MCA, or hold a current license as a licensed public accountant, have been licensed on or before December 31, 1970, and hold a current annual permit to engage in the practice of public accounting under section 37-50-314, MCA;
2. if a partnership or corporation, be currently registered as a partnership of certified public accountants or a corporation of certified public accountants under section 37-50-330, MCA, or be currently registered as a partnership of licensed public accountants or a corporation of licensed public accountants under section 37-50-330, MCA, and have been registered on or before December 31, 1970;
3. meet the continuing education requirements specified in Government Auditing Standards, as established by the U.S. Comptroller General;
4. have an external quality control review at least once every 3 years that meets the requirements specified in Government Auditing Standards, as established by the U.S. Comptroller General, and

receive an unqualified review report from the reviewing firm, team or association;

5. not have been restricted in the conduct of governmental auditing by the Montana Board of Public Accountants;
6. not have been debarred, suspended, proposed for debarment, declared ineligible, or otherwise excluded from performing audits by any state or federal department or agency;
7. not have been deemed ineligible to conduct local government entity audits by the Department:
 - i. because of failure to conduct local government entity audits under contract with the Department of Administration during the previous two years in accordance with the audit standards described in ARM 8.94.4105;
 - ii. because of failure during the previous two years to adhere to the terms and conditions of an audit contract with the Department, or
 - iii. because the independent auditor is more than 90 days delinquent in filing an audit report required under an existing contract with the Department of Administration and has not obtained the Department's written consent to an extension of the contracted filing date.
- e. An independent auditor may be removed by the Department of Administration from the roster of Independent auditors authorized to conduct audits of local government entities for failure to continue to meet the eligibility requirements specified above.
- f. If an independent auditor is removed by the department from the roster as provided in (e.) above, the independent auditor must complete the application form prescribed by the Department, meet the eligibility requirements set out in (d) above, and pay the fee specified in (i) below in order to again be placed on the roster.
- g. To remain on the roster, an independent auditor must complete and submit to the Department on or before June 30 of each year a renewal form prescribed by the Department on which the independent auditor certifies that the individual, partnership or corporation continues to meet the eligibility requirements specified above.
- h. To ensure that each independent auditor meets the eligibility requirements specified above, the Department of Administration may, at any other time during the year, require the independent auditor to submit to the department evidence that the

independent auditor meets the above eligibility requirements, including but not limited to documentation of required continuing professional education and the required external quality control review.

- i. At the time of original application to the department for placement on the roster, and at the time the annual renewal form is submitted to the Department of Administration, each independent auditor, including each office, shall pay to the Department of Administration a fee of \$50.00.
- j. If an independent auditor is removed from the roster, or if an independent auditor does not properly renew for continuance on the roster, any and all contracts for local government entity audits entered into under the provisions of section 2-7-506, MCA, to which the independent auditor is a party are terminated, and the Department of Administration will notify the local government entities of the termination. If an independent auditor is removed from the roster, the Department of Administration will not refund any portion of the fee paid to the Department of Administration by that independent auditor for placement on the roster.
- k. Upon notification of the termination of a contract for a local government entity audit, the local government entity must select another independent auditor from the Department of Administration's roster of independent auditors authorized to conduct local government audits and present a signed contract to the Department of Administration for approval within 90 days of notification of the termination.
- l. Upon termination of a contract for a local government entity audit, if the local government entity fails to present a signed contract to the department for approval with the 90 day period in (12) above, the Department of Administration will designate an independent auditor to perform the audit as provided by section 2-7-506(5), MCA.

2. Criteria for the Selection of the Independent Auditor

- a. In selecting an independent auditor to perform an audit under section 2-7-503, MCA, a local government entity shall consider the following criteria:
 - 1. listing on Department of Administration's roster of independent auditors authorized to conduct local government audits;
 - 2. independence, as defined by applicable auditing standards;
 - 3. demonstrated understanding of the work to be performed;
 - 4. technical experience of the independent auditor in conducting similar types of local government entity audits;
 - 5. qualifications of staff to be assigned to the audit;

6. work history of the independent auditor; and
 7. the proposed audit fee.
- b. The Department of Administration may require the local government entity to demonstrate that the independent auditor selected is qualified to conduct the audit based on an evaluation of:
1. the criteria established in (1) above;
 2. any additional information requested by and used by the local government entity in selecting the independent auditor; and
 3. the results of oral interviews of independent auditors conducted by the local government entity, if appropriate.

3. Use of Small and Minority Audit Firms

Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of OMB Circular A-133. Recipients of federal assistance shall take the following steps to further this goal:

- a. Assure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable;
- b. Make information on forthcoming opportunities available and arrange timeframes for the audit so as to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;
- c. Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;
- d. Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs and, in such cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities;
- e. Encourage contracting with consortiums of small audit firms as described in paragraph (a) above when a contract is too large for an individual small audit firm or audit firms owned and controlled by socially and economically disadvantaged individuals;

- f. Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

D. AUDIT CONTRACTS

- a. As provided by section 2-7-506(3), MCA, an audit of a local government entity by an independent auditor must be pursuant to a contract entered into by the governing body or managing or executive officer of the local government and the independent auditor.
- b. The Department of Administration must be a party to the contract, and work under the contract may not commence until the Department of Administration signs the contract.
- c. All contracts for conducting audits must be in a form prescribed by the Department of Administration.
- d. The Department of Administration will not enter into a contract in which the independent auditor and local government entity have not provided all of the information required by the contract form.
- e. The Department of Administration will not enter into an audit contract covering more than three consecutive fiscal years.

E. AUDIT COSTS

The costs of audits prepared in accordance with the provisions of OMB Circular A-133 are allowable charges to CDBG projects. **Costs of audits that are not prepared in accordance with the provisions of OMB Circular A-133 are not allowable charges to CDBG projects.**

Generally, **the percentage of costs charged to CDBG projects cannot exceed the percentage of CDBG funds expended in relation to total funds expended by the local government during the fiscal years covered by the audit.** The percentage may be exceeded, however, if appropriate documentation demonstrates higher actual cost. **The grantee must provide the necessary information required to determine the percentage of funds applicable to the CDBG project audit when the audit report and final certifications of completion are submitted for MDOC review.**

IV. AUDIT TRACKING

Due to the variety of audit situations, the specific audit option required is determined on a case by case basis. As an aid in determining which audit option will be required, the grantee should prepare a *Schedule of all Federal Financial Assistance (Exhibit 14-A)* at year-end. Preparation of the *Audit Tracking System (Exhibit 14-B)* for each project, will also provide a systematic and timely way to monitor such projects.

The grantee should also follow the specific instructions in **Chapter 13, PROJECT CLOSEOUT**, regarding preparation of the Project Completion Report/Certifications and the audit requirements for conditional and final project closeout.

V. SCOPE OF REQUIRED AUDITS

- A.** The audit will cover the entire operations of the entity or, if appropriate, it will cover individual CDBG projects, depending on the entity's audit threshold.
- B.** The auditor should determine whether:
 - 1. The financial statements of the entity present fairly its financial position and the results of its financial operations in accordance with generally accepted accounting principles;
 - 2. The organization has internal accounting and other control systems to provide reasonable assurance it is managing federal financial assistance programs in compliance with applicable laws and regulations; and
 - 3. The organization has complied with laws and regulations that may have material effect on its financial statements and on each major federal assistance program.

VI. FILING OF AUDIT REPORTS

AUDIT REPORT DISTRIBUTION REQUIREMENTS

- 1. Copies of the audit report should be filed as follows:

To Be Filed With:	To Be Filed By Auditor	To Be Filed By Entity
Local Governing Body	X	
County/City/Town Attorney	X	
County/City/Town Clerk	X	
Local Program Officer (when appropriate)		X
MDOC/Local Government Services		X
Cognizant Agency (when appropriate)		X
Single Audit Clearing House (see below)		X

2. The audit report must be filed within 30 days after its issuance but no later than nine months after the end of the audit period. For fiscal years beginning on or before June 30, 1998, the audit shall be completed and the data collection form and reporting package shall be submitted within 30 days after receipt of the auditor's reports, or 13 months after the end of the audit period. If a longer period is agreed upon with the cognizant or oversight agency for the audit, the entity should notify the Single Audit Clearinghouse so that the entity will not be listed as being delinquent in the filing of their report.

VII. ILLEGAL ACTS OR IRREGULARITIES

If the auditor becomes aware of illegal acts or other irregularities, prompt notice shall be given to the appropriate grantee officials. This notification should also include the respective county, city or town attorney. The grantee, in turn, shall promptly notify the cognizant agency of the alleged illegal acts or irregularities and of proposed and actual actions, if any. Illegal acts and irregularities include such matters as conflicts of interest, falsification of records or reports, and misappropriations of funds or other assets.

VIII. RESOLUTION OF AUDIT FINDINGS

The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee must prepare:

- a. a summary schedule of prior audit findings; and
- b. a corrective action plan for current year audit findings.

Summary Schedule: The summary schedule must include audit findings reported in the prior audit's summary schedule of prior audit findings, except audit findings listed as corrected, or no longer valid or warranting further action. In addition:

1. When audit findings were corrected, the summary schedule need only list the audit findings and state what corrective action was taken.
2. If audit findings were only partially corrected, the summary schedule must describe what actions will be taken to correct findings.
3. When corrective action is significantly different from corrective action previously reported, the summary schedule must provide an explanation.
4. When the auditee believes the audit findings are no longer valid or do no warrant further action, reasons for this position must be described in the summary schedule.

Corrective Action Plan: At the completion of the audit, the auditee must prepare a corrective action plan to address each audit finding included in the current year auditor's reports. The corrective action plan must provide the name(s) of the contact person(s)

responsible for corrective action, the corrective action planned, and the anticipated completion date.

X. AUDIT WORKPAPERS AND REPORTS

Workpapers and reports must be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers must be made available upon request to the cognizant agency or its designee or the General Accounting Office (GAO), at the completion of the audit.

CHAPTER 14

EXHIBITS

14-A Schedule of Federal Financial Assistance

14-B Audit Tracking System